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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re	No.	01-30923 DM
PACIFIC GAS & ELECTRIC COMPANY,	Chapter	11
Debtor.	Date:	July 13, 2001
	Time:	1:00 p.m.
	Ctrm:	Hon. Dennis Montali 235 Pine Street, 22nd Floor

UNITED STATES TRUSTEE'S OPPOSITION TO MOTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS FOR ENTRY OF AN ORDER PERMITTING TRADING IN COMMODITIES

I. INTRODUCTION

Linda Ekstrom Stanley, United States Trustee, opposes the Motion of the Official Committee of Unsecured Creditors for Entry of an Order Permitting Trading in Commodities because the motion (1) has no legal basis; (2) impermissibly seeks an advisory ruling from the Bankruptcy Court on whether particular measures termed "ethical walls" can insulate a committee member from liability for the use of confidential information; (3) may be intended to insulate particular members from removal from the official committee of unsecured creditors (the "Committee") by the United States Trustee if necessary.

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II. BACKGROUND

The supplemental disclosures prove how arcane the energy trading and information business is and how inappropriate it would be to enter any order approving the so-called "ethical walls." Each Members' situation is unique and complex. Each plays a different role in the market. Some trade with debtor, some provide market information, some trade only for others and some subsist entirely on trading. The Members consist of banks, brokerages, energy producers and commodity traders. It is unthinkable this pantheon of commercial interests could be served by a single, uniform order for ethical walls.

The Committee seeks an order permitting its members to trade in and publish research with respect to commodities of the type and kind used by the debtor upon the establishment of "ethical wall" procedures. Bank of America, Dynegy Power Marketing, Inc., Enron Corp., Merrill Lynch, Morgan Guaranty Trust Company of New York (the "Members") are the Members seeking this protection and they can be divided two groups: banks/investment houses and producers.

Banks/Investment Houses

Bank of America, Merrill Lynch and Morgan Guaranty Trust Company are banking institutions holding similar claims. Bank of America is an agent for unsecured bank debt, Merrill Lynch's interest is in commercial paper, and Morgan Guaranty is contingently liable on letters of credit. None of these three institutions are in the business of producing natural gas or electricity.

Merrill Lynch's need for the order appears most attenuated – it sold its "energy commodity trading business" and has only a modest connection to the market at this time. *See Declaration of Keith A. Bailey in Support of Commodities Trading Order* ¶ 4. Morgan continues to broker and clear transactions for institutional clients, but not on its own account, and does not provide research or advice in this area. *Declaration of Emily Portney of J.P. Morgan Futures Inc. In Support of Entry Of Commodities Trading Order* ¶ 2. On the other hand, Morgan's new merger-partner is Chase Manhattan Bank which "is a dealer in over-the-counter commodities derivatives and acts as a principal, for its own account."

Declaration of Jeffrey Dellapina Of The Chase Manhattan Bank in Support of Entry of Commodities Order ¶ 2. Bank of America seems most deeply involved in the energy trading market, as it provides "price risk management products, such as swaps, basis swaps, options, and structured transactions . . assist[ing] clients with limiting their energy price exposures and designing hedging structures." *Suppl. Decl. of David J. Mooney etc.* ¶¶ 2 -4.

Producers

Dynegy's business is producing and selling natural gas and electricity. Dynegy alleges it does not sell natural gas or electricity to the Debtor but it does sell to the Department of Water Resources. *Declaration of Nicholas Wallace* ¶ 4. Dynegy says its Canadian affiliate sells gas to the Debtor, Dynegy's representatives on the Committee are based in Houston and, although Dynegy trades in derivatives, its current transactions regarding derivatives were negotiated prior to the filing of the petition, and there are no current derivative negotiations pending. *Id.* at 6.

Enron presents by far the most complicated circumstance. Enron's *sine qua non* is trading. It describes its primary operations as devoted to the purchase and sale of commodities, including natural gas and electricity. *Suppl. Decl. of Michael Tribolet* ¶ 2. It even has a subsidiary named EnronCredit, which was founded "to trade bankruptcy swaps." *Request for Judicial Notice*, Exhibit A. Unlike Dynegy, Enron is either unable or unwilling to explain in any kind of depth its involvement in the contracts for derivatives, swaps or any other kinds of commodity trading with the Debtor – instead attaching a copy of its long marketing brochure which just serves to support the conclusion its role is hopelessly complex. While Dynegy indicated it does not trade or sell with the Debtor, Enron has not and apparently cannot make such a pledge. Enron's business involves buying and selling natural gas and electricity futures while serving, a business it intends to continue while a Member.

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III. ARGUMENT

A. The Relief Requested Is Unsupported by Law and Is Unnecessary – Members Who Discharge Their Fiduciary Obligations Will Be Insulated From Liability For Misuse of Confidential Information

Movants do not cite a single case supporting their request permitting them to establish an ethical wall between Members of the committee and the "traders". They rely instead on the logic of the previously issued "securities" order in support of their position. The securities order and whatever logic or law supports it have no application to the "commodities" question presented. This request must be denied.

The theory underlying the "securities" order is found in the SEC's support for protection to highly regulated firms receiving confidential information as members of a creditors' committee. The SEC monitors these firms and it is the SEC's considered judgment regulated firms are better off creating ethical walls under court authority and with SEC supervision than making themselves susceptible to liability under Rule 10(b)-5 as insiders. That much is plain from the brief attached to the Committee's original motion.

The "commodities" trading request now before the court is distinguishable. The SEC does not regulate commodity traders. Even if it did, no legal basis exists for the commodities order. The general rule is that a firm cannot use inside-creditor-committee information to its advantage.

> Another aspect of good faith is the avoidance of self-dealing. This means that a member of a chapter 11 committee may not use the position or the information gained thereby to foster the member's own interest as a creditor or an equity security holder. The members also should refrain from trading the securities of, or claims against, the debtor.

L. King, COLLIER HANDBOOK FOR CREDITORS' COMMITTEES ¶ 16.02[2] (2000). According to the Third Circuit, "A committee member violates its fiduciary duty by pursuing a course of action that furthers its self-interest to the potential detriment of fellow committee members." *Westmoreland Human Opportunities, Inc. v. Walsh (In re Life Serv. Sys.)*, 246 F.3d 233, 256 (3d Cir. 2001). It is each committee Member's duty to meet this fiduciary obligation and

discharge it.[1] Failure to act in a manner consistent with this duty will result in removal by the United States Trustee.

Enthused by the securities order, certain Members now seek an exception allowing them to trade the same commodities as debtor (e.g., energy and energy-futures contracts) while sitting on the Committee. They urge the ethical wall should insulate them from liability for this work. The ethical wall is an interesting device, and the Committee would have us believe it is acceptable because it looks just like the ethical wall on the securities side. But the "ethical wall" built just for commodities is a substantially different kind of wall – it does not bear the SEC's *imprimatur.* The SEC neither monitors nor reviews such "walls."

The committee has argued an ethical wall is even more important where there is no SEC oversight, asserting such motions and such walls bring important relationships to the foreground. The weakness of this argument is that no one reviews the ethical wall set up for "commodities" because that is beyond the SEC's purview. If the committee establishes the wall, who can monitor it? Do the firms have internal control teams? Do they employ an ethical specialist devoted to this issue?

Rather than ruling on this motion, the Court should leave the committee Members with their fiduciary duties and insist they discharge them. As Committee Members, it is their obligation to preserve confidences and their risk for failing to do so.

B. Absent Any Allegation of *Actual* Breach of Fiduciary Obligations or Conflict of Some Kind, the Motion Seeks an Advisory Opinion and Presents a Non-Justiciable Issue

The motion for an order permitting commodities trading upon the erection of an "ethical wall" requests "nothing more than an advisory opinion based on a hypothetical

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[1] As part of their obligation to represent creditor interests as a whole, members of a committee have fiduciary obligations. *In re Enduro Stainless, Inc.,* 59 B.R. 603, 605 (Bankr. N.D. Ohio 1986). In this capacity, committee members owe the other members of the represented class their undivided loyalty and allegiance. *Pension Benefit Guar. Corp. v. Pincus, Verlin, Reich & Goldstein P.C.,* 42 B.R. 960, 963 (E.D. Pa. 1984); *In re Haskell-Dawes, Inc.,* 188 B.R. 515, 522 (Bankr. E.D. Pa. 1995). The Supreme Court has cautioned that the "whole body of law" imposes "the most rigorous responsibilities for fair dealing" on fiduciaries who represent the rights of others. *Young v. Higbee Co.,* 324 U.S. 204, 213 (1945). As a consequence of a committee member's role as a fiduciary, it "may not act through the committee in such a manner as to promote only that creditor's interest. *Enduro Stainless,* at 605.

scenario." *In re Rickel Home Centers, Inc.*, 209 F.3d 291, 306 (3d Cir. 2000*), citing* 15 J. Moore et al., MOORE'S FEDERAL PRACTICE § 101.75, at 101-152 (Matthew Bender 3d ed. 1999). Article III of the Constitution forbids federal courts from deciding a case in the absence of a controversy. U.S. Const. art. III. The ripeness doctrine "prevent[s] the courts, through avoidance of premature adjudication, from entangling themselves in abstract disagreements . . . ." *Id. citing Abbott Lab. v. Gardner*, 387 U.S. 136, 148, 87 S.Ct. 1507, 18 L.Ed.2d 681 (1967)*; In re Drexel Burnham Lambert Group, Inc.*, 995 F.2d 1138, 1146 (2d Cir. 1993). Whether an issue is justiciable depends on the "fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration. *Id. citing Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n.,* 461 U.S. 190, 201, 103 S.Ct. 1713, 75 L.Ed. 2d 752 (1983)*; Pic-A-State Pa., Inc. v. Reno*, 76 F.3d 1294, 1298 (3d Cir.), *cert. den.* 517 U.S. 1246, 116 S.Ct. 2504, 135 L.Ed.2d 194 (1996).

Three things must be shown to satisfy this constitutional mandate:

> First, the plaintiff must have suffered an "injury in fact: -- an invasion of a legally protected interest which is (a) concrete and particularized and (b) 'actual or imminent' . . . Second, there must be a causal connection between the injury and the conduct complained of -- the injury has to be 'fairly . . . trace[able] to the challenged action of the defendant, and not . . .the result [of] the independent action of some third party not before the court.' Third, it must be 'likely,' as opposed to merely 'speculative,' that the injury will be 'redressed by a favorable decision.'

I.R.S. v. Amoskeag Bank Shares, Inc. (In re Amoskeag Bank Shares, Inc.), 239 B.R.653, 657 (D. N.H. 1998); *quoting Luhan v. Defenders of Wildlife*, 504 U.S. 555, 560-61,112 S.Ct. 2130 (1992).

Movants cannot satisfy the "case or controversy standard." Movants want a "comfort" order permitting them to do what *they think is appropriate* to preserve the confidences they receive as Committee Members. No one asserts the Members have breached their fiduciary obligations or have used the information to their peculiar pecuniary advantage. Debtor has not raised the issue of whether the Members are receiving confidential information which they could use to their benefit. To the extent Debtor believes

particular Members will mis-use confidential information, it can request a protective order or enter into a confidentiality agreement.

Nor have the Members shown that they will suffer any hardship if the Court refuses to enter an order insulating the Members from liability. No one has shown any individual Member has access to confidential information which it might use to its singular benefit. As the current dispute over discovery concerning PG&E's adversary proceeding against the ISO demonstrates, confidentiality agreements already exist with respect to commodity trades.

Absent an actual dispute, any opinion the Court could render on the appropriateness of an ethical wall is an "exercise in futility." *Rickel* at 307. There is no case or controversy, there is no justiciable issue, and no order can issue.

C. Movants Have Not Established A Proper Record to Support A Conclusion the "Ethical Wall" Is Appropriate

An example will demonstrate the fallacy of the pending motion. A parking lot operator must discharge a common law obligation to operate the facility appropriately and to provide a safe place for customers. Suppose an operator decided to set up a particular kind of lighting and fencing, to employ a security service and to drive by the lot frequently. Would this operator, secure in the knowledge he was doing his utmost to protect his customers, be successful in an application to a court for an order holding these safety measures were appropriate to prevent liability in the event he injured a future customer? The answer is simple -- "no."

The Committee seeks an order saying much the same thing the parking lot operator sought – its Members want an order saying if they conduct themselves in a particular way, they will not be liable for any otherwise problematical use of confidential information. Before granting this motion, the Court should ask whether movants have made the question completely clear and conclusively shown the "ethical wall" sought to be employed will work. Ordinarily, of course, parties in interest would conduct discovery to create a record for advocacy and review; here, by contrast, movants ask the court and parties to work in the

dark.

In a recent communication with the United States Trustee, Enron's counsel wrote:

> Enron engages in market-making activities in credit derivatives through indirectly wholly-owned subsidiaries in Houston . . . and London . . . . Credit derivatives are financial instruments in which two parties trade on a credit-related risk involving a third party (such as a bond default). Enron engages in this trading over-the-counter with counterparties qualified under applicable law. From time to time, such activities involve direct trading in debt and equity securities (e.g., to hedge an exposure arising under a given credit derivative position or for Enron's account) . . .

The United States Trustee has no reason to doubt the accuracy of this statement, but the precise meaning of these words eludes her and, she suspects, most lawyers. Given the complexity of the situation, the Court should ask whether movants have demonstrated conclusively and with appropriate detail the nature of the "ethical walls" and how they will work.

D. Committee Members Should Not Be Insulated From Removal From the Committee By An Order Authorizing Trading in Commodities

The motion seeks an order approving in advance a course of conduct by Committee Members which, if followed, purports to immunize certain trading activity. The United States Trustee is concerned these measures are also intended to insulate particular Members from removal from the committee by the United States Trustee if that became necessary.

Section 1102 of the Bankruptcy Code directs and authorizes the United States Trustee to appoint a creditors' committee. The appointment of *individual members* of a creditors' committee is committed to the discretion of the United States Trustee. *In re Wheeler Technology, Inc.,* 139 B.R. 235 (Bankr. 9th Cir. 1992)*; Victory Markets, Inc.*, 196 B.R. 1, 4 (Bankr. N.D. NY. 1995). The actual composition of the membership of any committee is an administrative task entrusted solely to the United States Trustee by statute and the United States Trustee's duties include monitoring the same creditors' committees appointed under chapter 11. *Id., citing* 11 U.S.C. § 586(a)(3)(E).

Like the premise of this motion, barely visible in a hazy field of supposition, there is no actual allegation any Member has breached its duty to the unsecured creditor body. If

the United States Trustee believed any Member of the Committee had breached a fiduciary duty imposed on them by law, though, she might remove that Member. The motion seems intended to strike preemptively – to seek a ruling that a particular kind of "ethical wall" is appropriate – purportedly blunting the United States Trustee's ability to take appropriate action. No order should issue under the circumstances which would limit the United States Trustee's discretion (and, potentially, obligation) to alter the membership of a creditors' committee.

IV. CONCLUSION

For the foregoing reasons, the United States Trustee urges the Court deny the Committee's motion.

Date: July 2, 2001

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By: _____
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